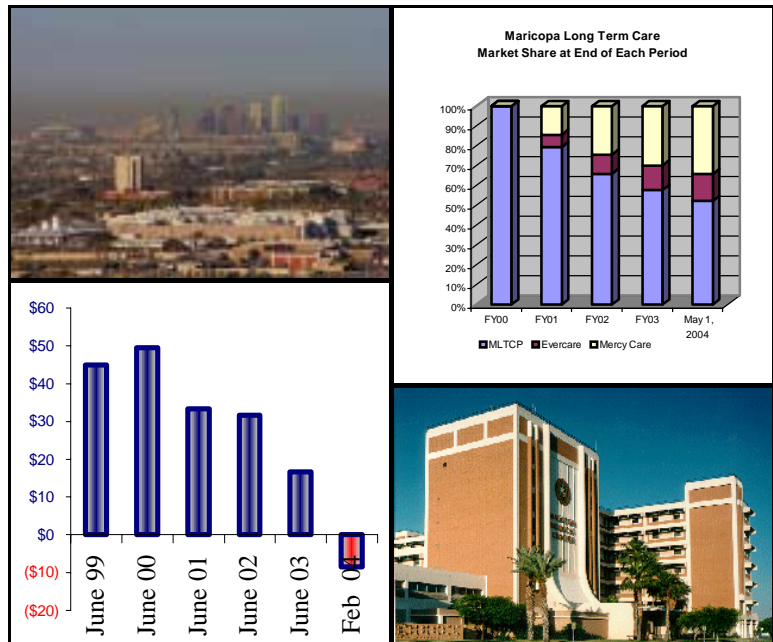




# Internal Audit Department

## Maricopa Integrated Health System Financial Condition Report

July 2004



## County Auditor

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# Maricopa County

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July 30, 2004

Andrew Kunasek, Chairman, Board of Supervisors  
Fulton Brock, Supervisor, District I  
Don Stapley, Supervisor, District II  
Max W. Wilson, Supervisor, District IV  
Mary Rose Wilcox, Supervisor, District V

We have completed the FY 2003 edition of the Maricopa County Financial Condition Report. This year features Maricopa Integrated Health System (MIHS) key financial trends at the beginning of the report and concludes with General Fund financial trends. In certain instances, MIHS charts have been updated through April 2004. This work, which is part of our Board-approved audit plan, provides important information on County financial conditions and trends over the past five to ten years.

The challenges facing MIHS are apparent in this report. Overall, MIHS cash levels have dropped to critically low levels, and the Long Term Care health plan is steadily losing membership and profitability. Although Maricopa County's General Fund continues to increase its strong financial position, the General Fund will be vulnerable to MIHS financial stresses until the health system is stabilized and transitioned to the new healthcare district.

Evaluating a jurisdiction's financial condition is a complex process, especially during uncertain economic times. Many variables are difficult to isolate and quantify. We believe, however, that a routine assessment of the past provides insight for the future, allowing us to make informed decisions in critical times. Additionally, a comparison to benchmarks broadens our perspective. This type of financial analysis alerts County officials to potential concerns and facilitates the Board's governance of Maricopa County.

Sincerely,

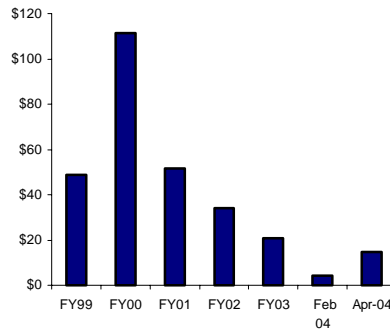
A handwritten signature in cursive script that reads "Ross L. Tate".

Ross L. Tate  
County Auditor

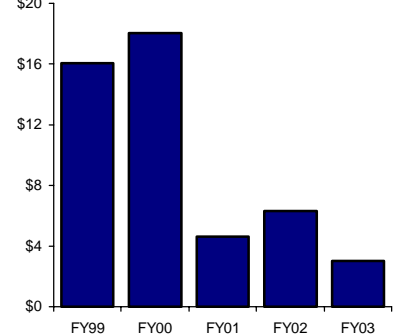
# Overview



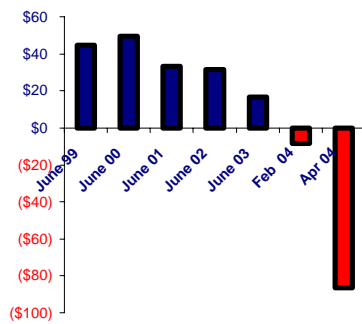
**Health System Cash is depleted**  
Page 3



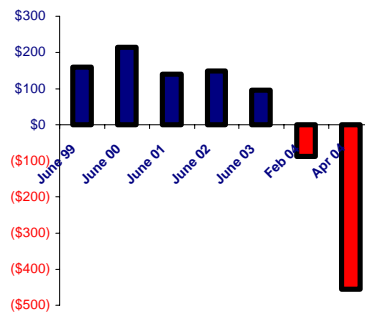
**Health System Profits Decline**  
Page 5



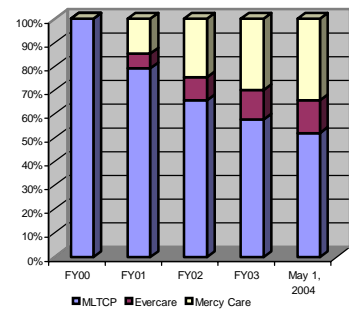
**Health Plans' Profits Decline**  
Page 5



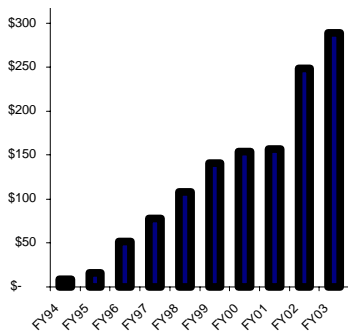
**MLTCP Is Not Profitable**  
Page 7



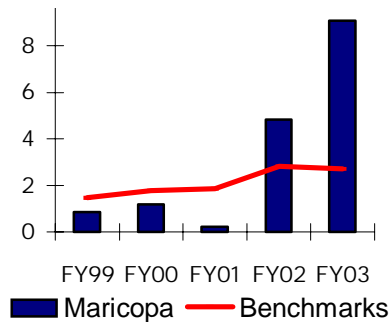
**Maricopa Long Term Care  
Market Share at End of Each Period**



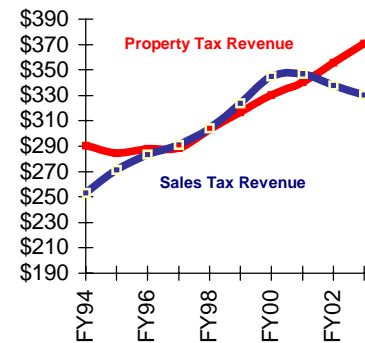
**Strong General Fund Equity**  
Page 12



**Strong General Fund Liquidity**  
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**General Fund Revenue Trend**  
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# Maricopa Integrated Health System Overview

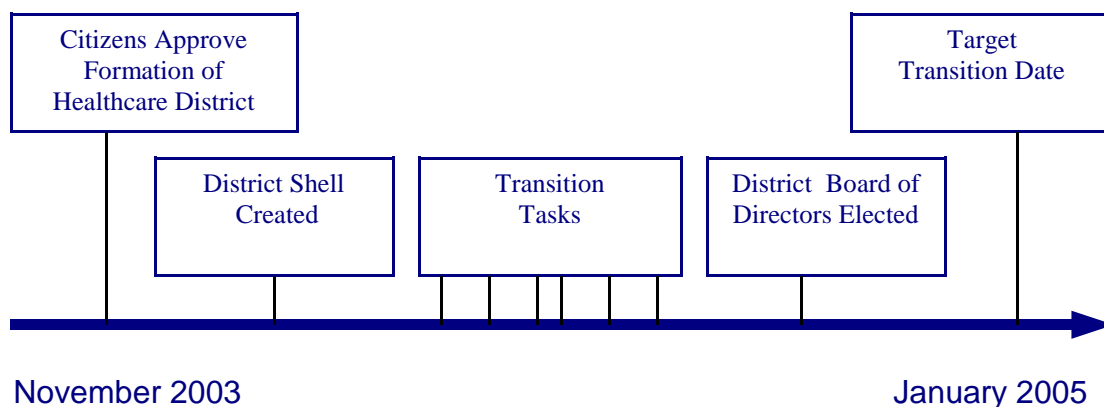
Maricopa Integrated Health System includes the following entities:

- Maricopa Medical Center (hospital / delivery system)
- Maricopa Health Plan (ambulatory managed care)
- Maricopa Long - Term Care Program (MLTCP / ALTCS)
- Health Select (managed employee care)
- Senior Select (Medicare plan)

In November 2003, Maricopa County voters authorized the formation of a separate healthcare district. The formation will mean that employees of Maricopa Integrated Health System (MIHS) may become employees of the new district. The district will have a board of directors, consisting of 5 elected members that will have the power to levy secondary property taxes and issue bonds for up to 20 years. The secondary property tax would have an initial cap of \$40 million dollars. State law allows the cap to increase 2% a year and factors in growth.

Maricopa County intends to turn the health system over to the new district in January 2005. Currently, health system employees and County administrators are working to resolve problems with health plan billing systems, cash flow deficits, and falling profitability in order to ensure a clean transition from the County to the special district.

## Transition Timeline



Maricopa County is experiencing a difficult period in transitioning its healthcare system to the new special district. Although the County's General Fund continues to have a strong financial position, the County's health system is facing severe problems on several fronts. These problems have the potential to cost the General Fund many millions of dollars before the health system is stabilized and transitioned to the new voter-approved special health district.

The most prominent issues facing the transition are:

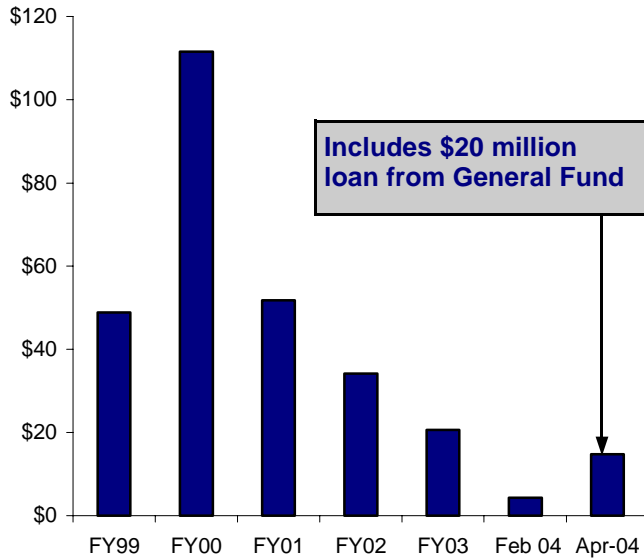
- On-going challenges of operating a healthcare delivery system with large numbers of non-paying patients
- Obsolete infrastructure and capital investment needs at the medical center and clinics
- Declining market share / profitability in Long Term Care and Senior Select health plans
- Critically low cash levels
- Failure to successfully implement a new health plans claims payment system

The following pages portray troubling financial trends in the healthcare system, followed by more positive trends in the County's General Fund.



# MIHS Has Depleted Its Cash

**MIHS Combined Cash (Millions)**



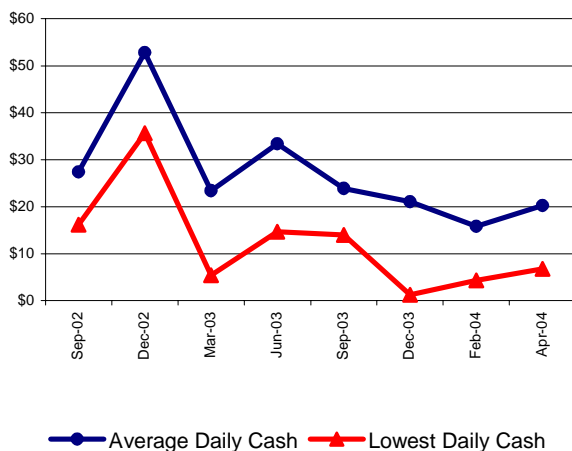
The decline is attributed to:

- Declining health plans profitability
- Hospital capital expenditures

The Board of Supervisors approved a General Fund line of credit in November 2003. In April 2004, the outstanding General Fund loan to the health system reached \$20 million.

(MIHS repaid the loan in June 2004 when the General Fund permanently transferred \$41 million to MIHS.)

**MIHS Average Daily Cash (Millions)**



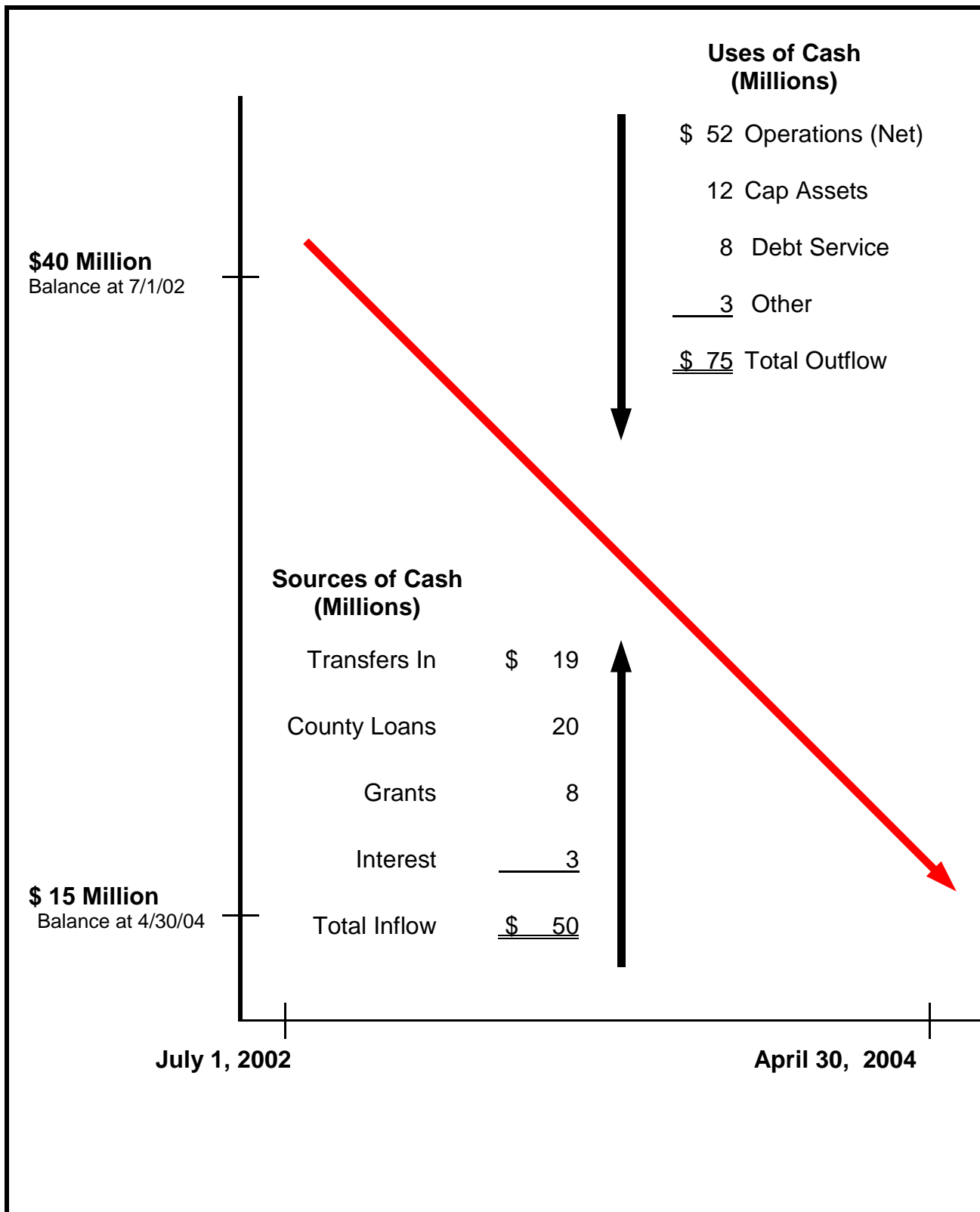
Averaging daily cash balances over each month is useful for closer viewing of cash trends over shorter time periods.

The December 2002 peak represents a period when health plan claims were not paid while the new claims payment system was being implemented. Although the system has failed to accurately process claims, cash dropped when estimated payments were made.

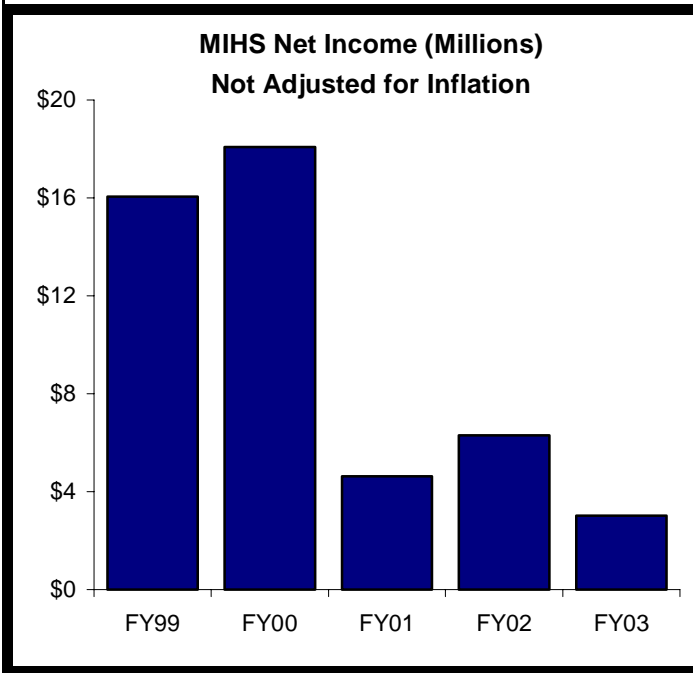
The lowest cash balances in several months approached zero, and would have dipped below zero without General Fund loans to the system.



# MIHS Cash Declined \$25 Million in 21 Months

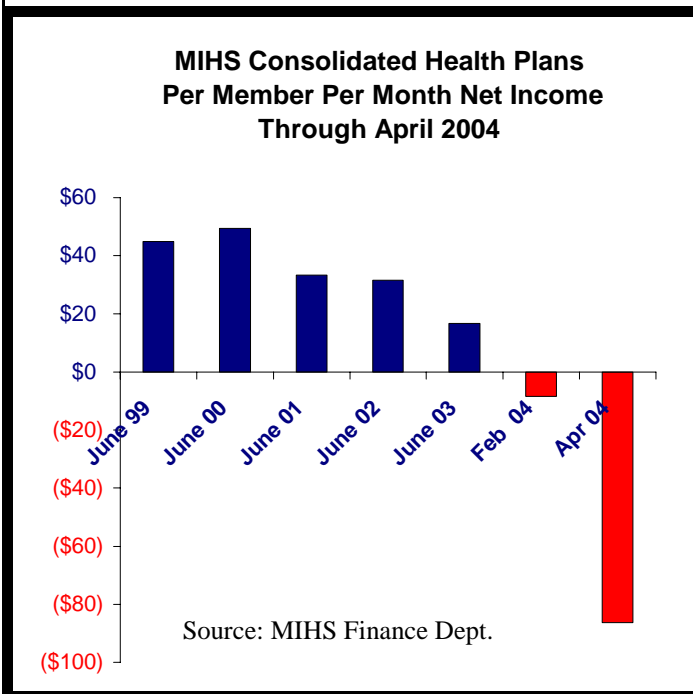


# MIHS Net Income has Declined



Declining health plans' profitability hurt the health system.

Maricopa Long Term Care Program's decline had the largest impact on the system (see following sections).



Consolidated health plans' profitability is often measured as a per member per month ratio. FY04 losses of \$86 per member per month were reported through April 2004. The loss includes a cumulative adjustment for medical expense accruals as estimated by an independent consultant.

The recent revaluation of medical expense estimates suggests that prior financial reporting may have overstated profitability.

The most troubling trend involves the Maricopa Long Term Care Plan (MLTCP), also known as ALTCS (see following page).

# Maricopa Long Term Care Program (MLTCP)

## Program Description

The Maricopa Long Term Care Program (MLTCP) is a managed care, long term care plan operated by Maricopa Managed Care Systems. Chronically ill and physically disabled patients receive medical services as a result of an annual contract with the Arizona Health Care Cost Containment System (AHCCCS).

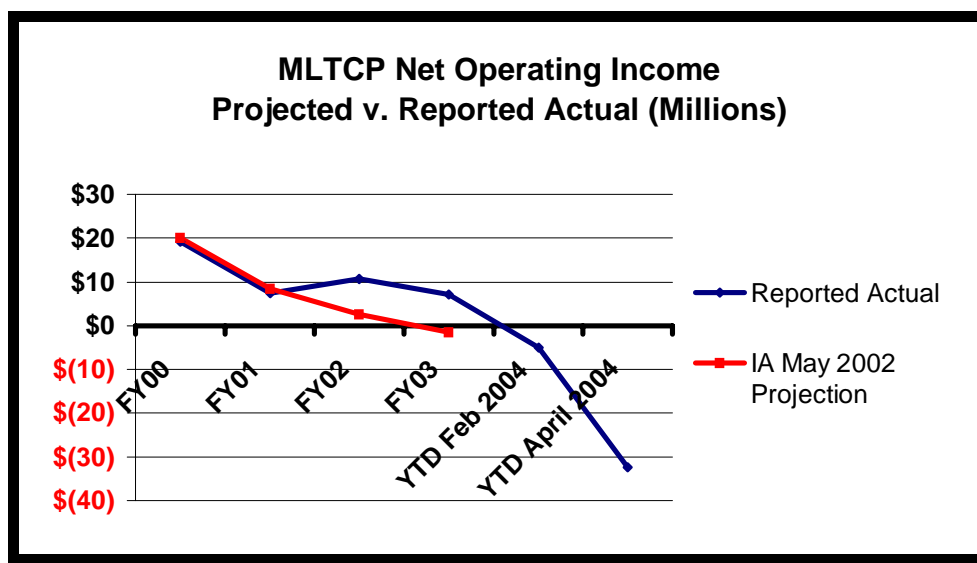
## Membership and Profitability

In past years, MLTCP earned large profits and accumulated large cash balances that management viewed as offsetting Medical Center cash deficits. Since FY00, MLTCP has steadily lost membership and profitability.

In May 2002, Internal Audit (IA) reported projected MLTCP losses as early as FY03 (see chart below), primarily from the following factors:

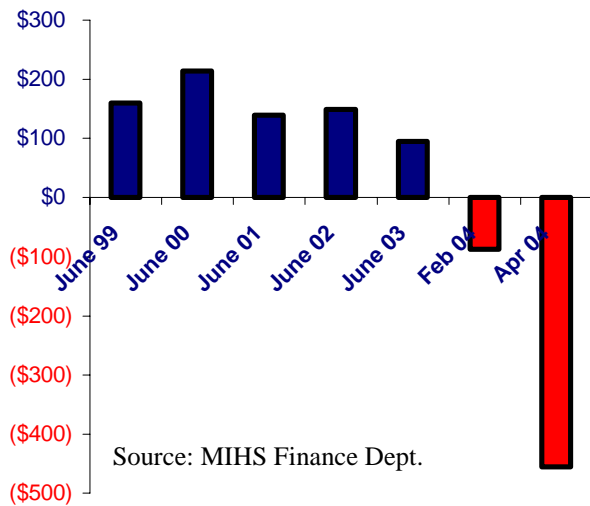
- Competition from two other ALTCS health plans operating in Maricopa County
- Increasing Home and Community Based Services (HCBS) per member per month costs
- General and administrative cost increases (relative to revenues)

Actual losses were first reported by MIHS in FY04. Current analysis of medical expense accruals may lead to larger losses than those reported.



# MLTCP Cost Increases Outstrip Revenue Increases

**MLTCP**  
Per Member Per Month Net Income  
Through April 2004

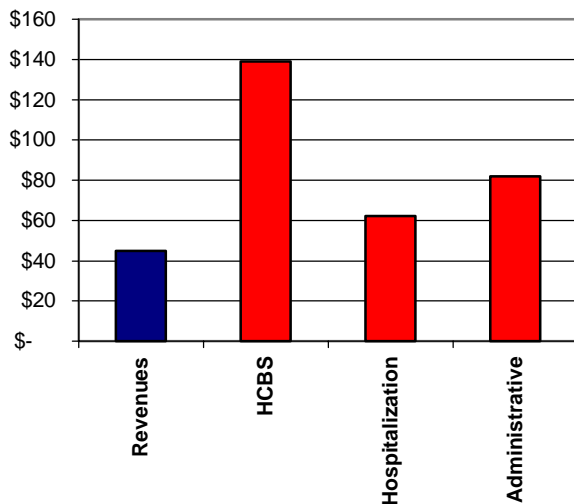


## Per Member Per Month Net Income (Loss)

### Troubling Trends:

- \$456 per member per month net loss for first 10 months of FY04.
- Recent evaluation of medical expense estimates suggests that prior financial reporting overstated profitability.

**Increases in Per Member Per Month  
Revenue and Key Expenses - First 10  
Months FY04**



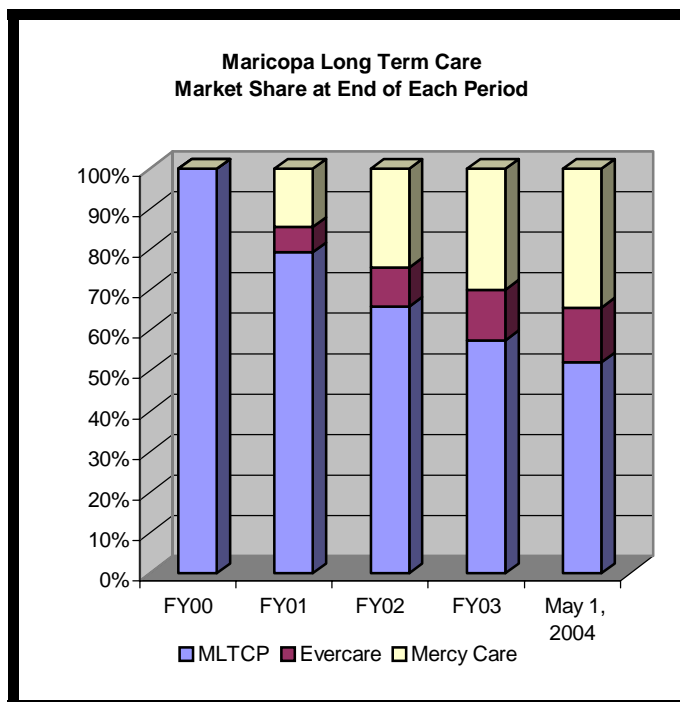
## Per Member Per Month Costs Outstrip Revenues

- Per member per month revenues increased \$45.
- Per member per month expenses increased much more than revenues:
  - Home and Community Based Services up \$139
  - Hospitalization up \$62
  - Administrative expenses up \$82

# MLTCP Market Share Decreases

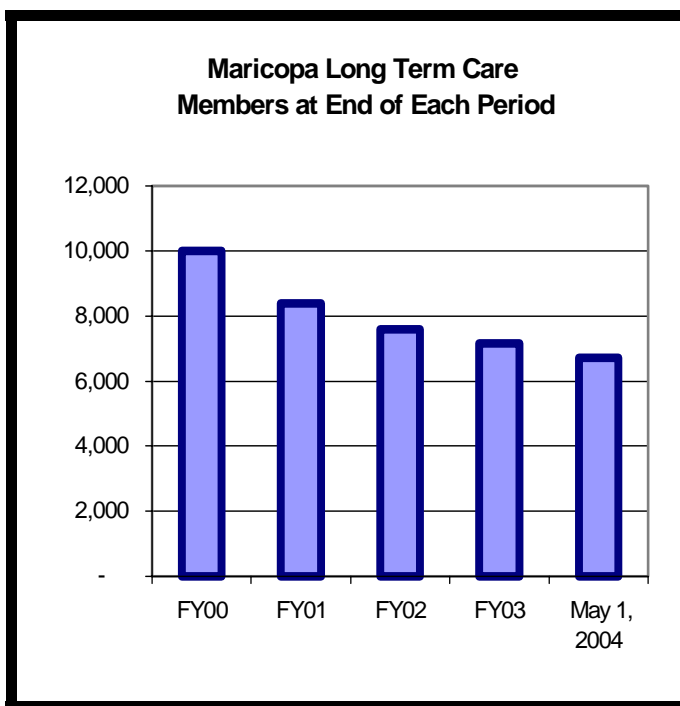
## MLTCP Continues to Lose Market Share

- State of Arizona opened Long Term Care Program to competition in FY00.
- Since FY00, market share has declined 1% per month.
- As of May 1, 2004, MLTCP has only 52% of AHCCCS long term care health plan members.
- Market share losses contribute to lower profitability.



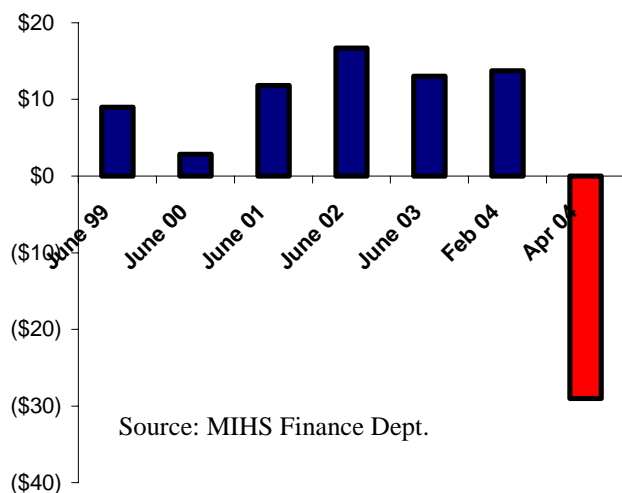
## MLTCP Continues to Lose Members

- In less than four years, MLTCP has lost 3,200 members. This represents nearly a third of the FY00 membership level.
- Member loss trends have not slowed.



# Maricopa Health Plan (MHP)

**Health Plan (Acute Care)  
Per Member Per Month Net Income  
Through April 2004**

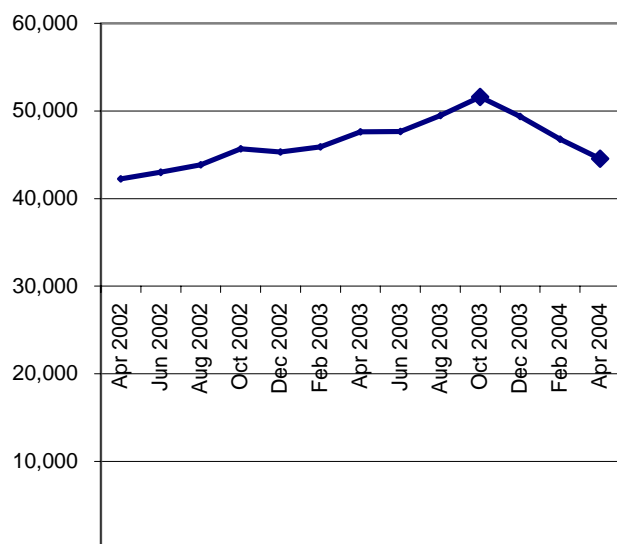


- \$29 per member per month loss for the first 10 months of FY04. The loss includes a cumulative adjustment for medical expense accruals as estimated by an independent consultant.
- The recent revaluation of medical expense estimates suggests that prior financial reporting may have overstated profitability.

## Program Description

The Maricopa Health Plan is an ambulatory health care plan operated by Maricopa Managed Care Systems (MMCS). MMCS contracts with the Arizona Health Care Cost Containment System (AHCCCS) which provides monthly capitation revenues based on MHP enrollment. AHCCCS is Arizona's version of Medicaid and is based on a managed care model.

**Maricopa Health Plan Membership**



- Membership peaked at 51,598 in October 2003.
- April 2004 membership dropped to 44,539.

# Senior Select

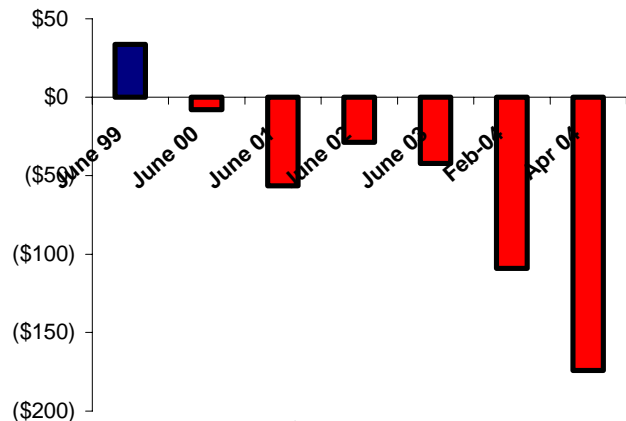
- \$174 per member per month loss for the first 10 months of FY04. The loss includes a cumulative adjustment for medical expense accruals as estimated by an independent consultant.
- The recent revaluation of medical expense estimates suggests that prior financial reporting may have overstated profitability.

## Program Description

The Maricopa County Senior Select Health Plan (MSSP) is a “Medicare+Choice HMO” Plan offered to individuals who are eligible to receive Medicare benefits. The plan, which began in November 1993, provides additional care for qualifying Maricopa Long-Term Care Plan (MLTCP) members not traditionally covered under Medicaid.

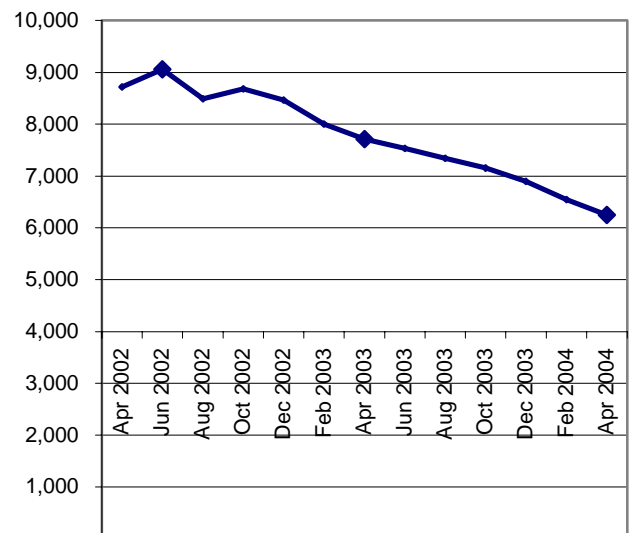
- Membership peaked at 9,060 in June 2002.
- The Centers for Medicare and Medicaid Services (CMS) capped membership at 7,754 effective May 1, 2003.
- The April 2004 membership dropped to 6,248.

**Senior Select  
Per Member Per Month Net Income  
Through April 2004**



Source: MIHS Finance Dept.

**Senior Select Membership**



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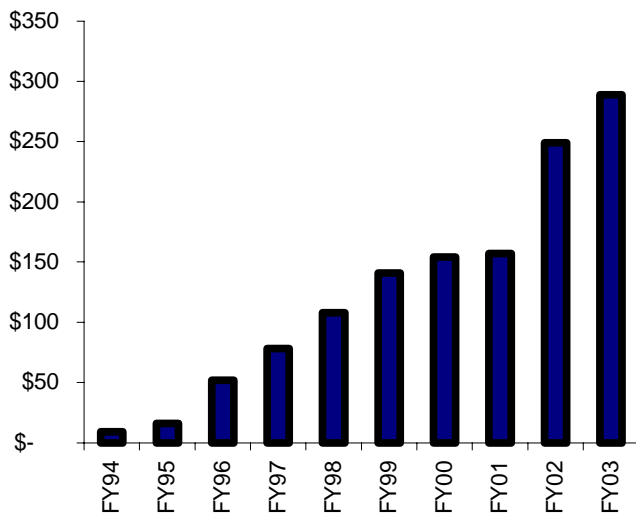
# Maricopa County General Fund



The General Fund is the County's primary operating fund. Conservative fiscal policies have led to strong financial positions in equity, liquidity, and general long term debt. The following pages demonstrate strong General Fund positions. However, health system financial problems pose a potential drain on General Fund resources.

Approximately two years ago, symptoms of MIHS financial problems began to surface. The first symptom noted was a steep decline in health system cash balances. Until a complete analysis of health system finances and operations could be achieved, County administrators scaled back on large capital projects, including a new administration building, in order to reserve General Fund resources for potential health system shortfalls.

**General Fund Balance (Millions)**



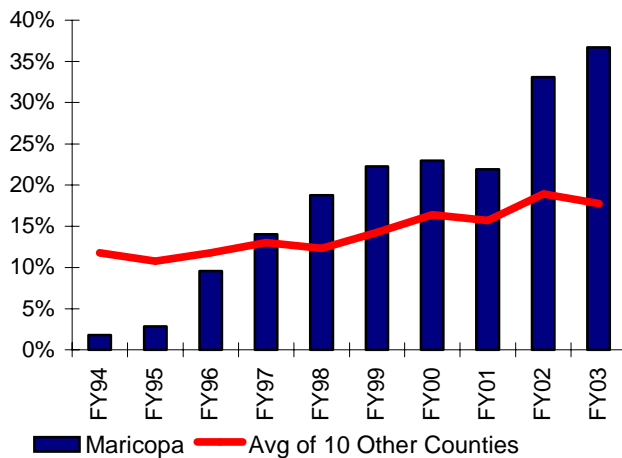
Conservative budget strategies have resulted in healthy General Fund balance increases.

The fund balance did not grow in FY01 because the County set money aside to fully fund several construction projects.

The fund balance rose sharply in FY02 because additional money budgeted to fund construction projects was kept in the General Fund. County management determined that such funds may be needed for worsening economic conditions, potential cost shifting by the state, and deteriorating financial trends in the County's healthcare system.

# General Fund Revenues Exceed Expenditures

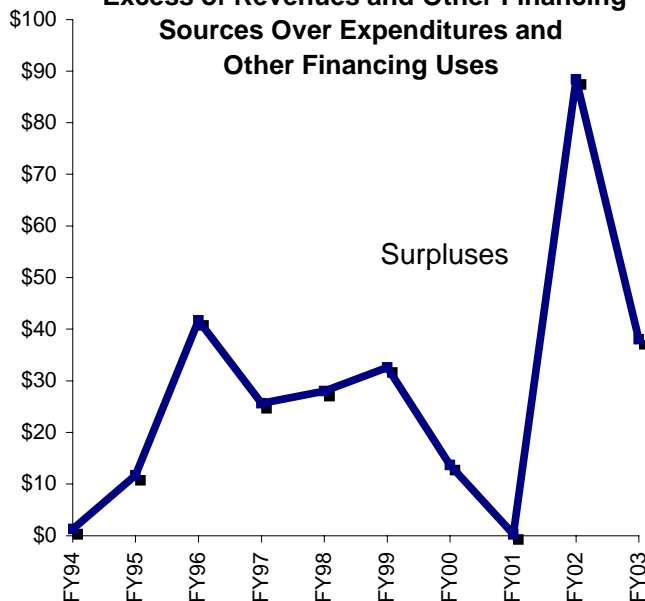
**Benchmark Counties:  
General Fund Balance as a Percent of  
Revenues**



Since FY96, Maricopa's General Fund has achieved a healthy fund balance in relation to its revenues. Since FY97, Maricopa has significantly surpassed the average of ten benchmark counties for this financial measure.

Strong General Fund equity will serve the County's citizens during current and future financial challenges.

**General Fund (Millions)  
Excess of Revenues and Other Financing  
Sources Over Expenditures and  
Other Financing Uses**



Since FY95, the General Fund has consistently spent less than it takes in, causing fund balance growth and increased cash availability for paying obligations.

The FY01 dip reflects the transfer of money to fund construction projects.

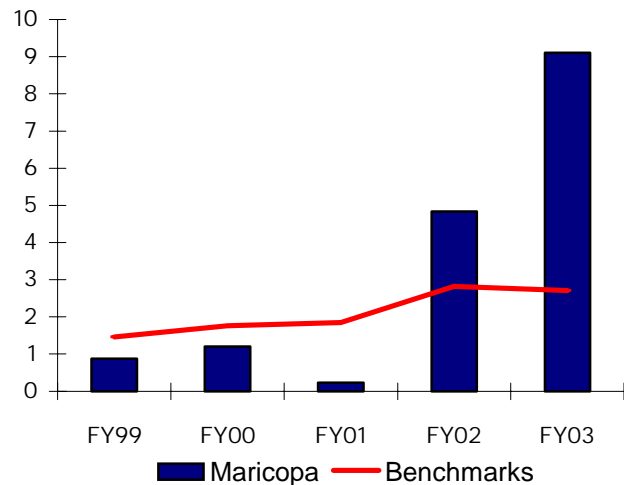
The FY02 upward spike reflects deferred construction projects and a decision to keep additional money in the General Fund for future needs.

# Strong Liquidity and Long-Term Debt Ratios

Although the General Fund shows a strong liquidity ratio in FY03, the General Fund may face fiscal challenges from the ongoing budget shortfalls at the State and from troubled financial conditions at MIHS.

Maricopa County's conservative fiscal policy places it in a better position to meet these challenges. Maricopa County's strong liquidity far exceeds the benchmark counties.

**General Fund Liquidity Ratio  
(Excluding Due From/To Other Funds)**

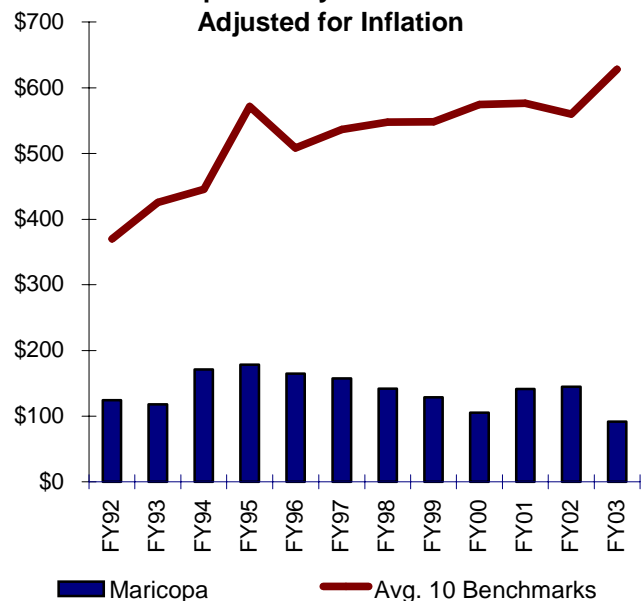


Maricopa County has very low debt levels compared with the average of benchmark counties.

Maricopa's low debt level has resulted from a conservative, "pay as you go" approach to financing new capital assets/projects.

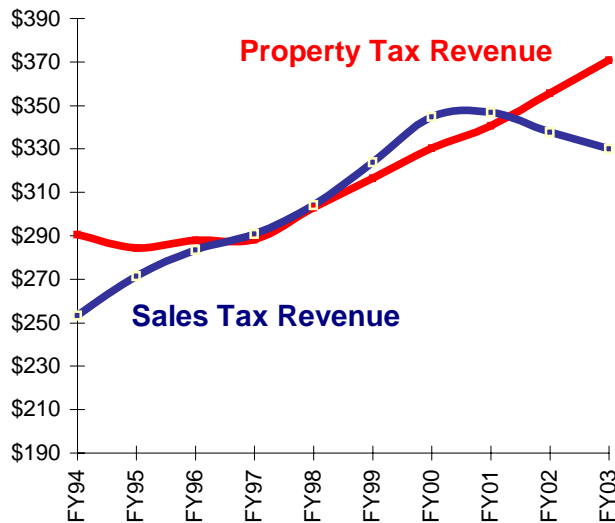
FY04 is the last year of the County's 1986 voter approved general obligation debt financing for capital projects. As of July 2005, Maricopa County will be considered free of general obligation debt.

**Long Term Debt Per Person  
Maricopa County vs. Benchmarks  
Adjusted for Inflation**



# Inflation and Declining Sales Hurt Revenue Trends

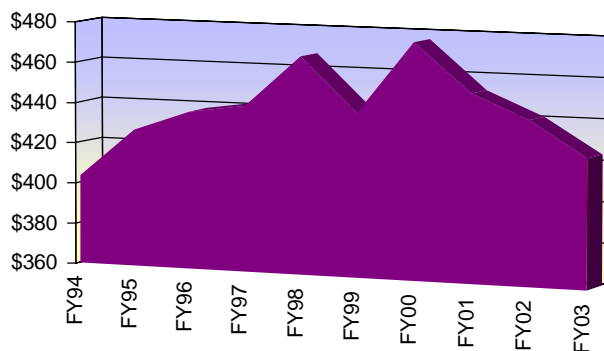
**Property vs. Sales Tax Revenues  
Adjusted for Inflation (Millions)**



Although sales tax revenues have become relatively more important in recent years, the upward trend of inflation-adjusted sales tax reversed in FY02.

As Maricopa County has increased its reliance on sales taxes to support services, it has been more directly affected by economic trends.

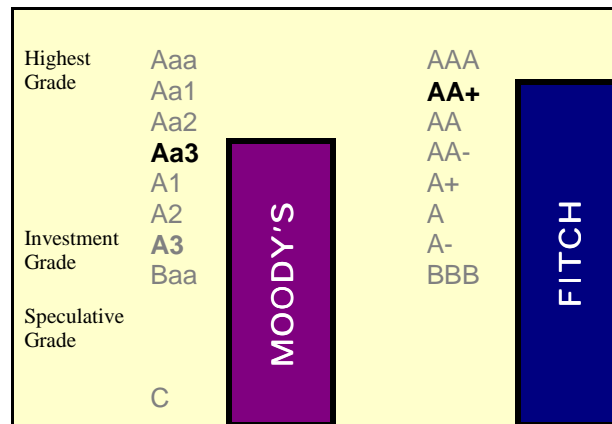
**General Governmental Revenues  
Per Person  
Adjusted for Inflation**



In recent years, General Government revenues have not kept up with population growth and inflation. Even though governmental revenues may increase in dollars, revenues (adjusted for inflation and population) actually declined.

However, the County fund balance is healthy, which indicates that although revenues are down, spending is under control.

# General Obligation Bond Ratings are Strong

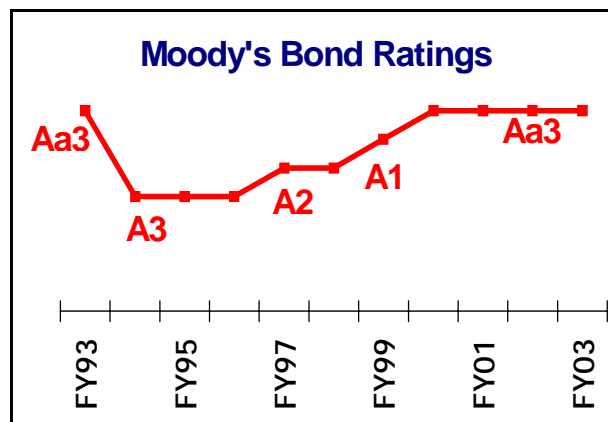


## Financial Strength is Reflected in the County's General Obligation Bond Ratings:

The County's financial position declined in the early 1990's. The County responded by restructuring its finances. Recent ratings by Moody's and Fitch are considered investment grade.

### Moody's — Aa3

The chart presented above shows that Maricopa County's long-term bonds, rated **Aa3** by Moody's, are considered high-grade bonds. The following graph shows that Maricopa County's trend since June 1994 has been one of improving ratings. In announcing its rating upgrade, Moody's referred to improvement in the County's financial condition, conservative fiscal strategies, and the County's low debt position.



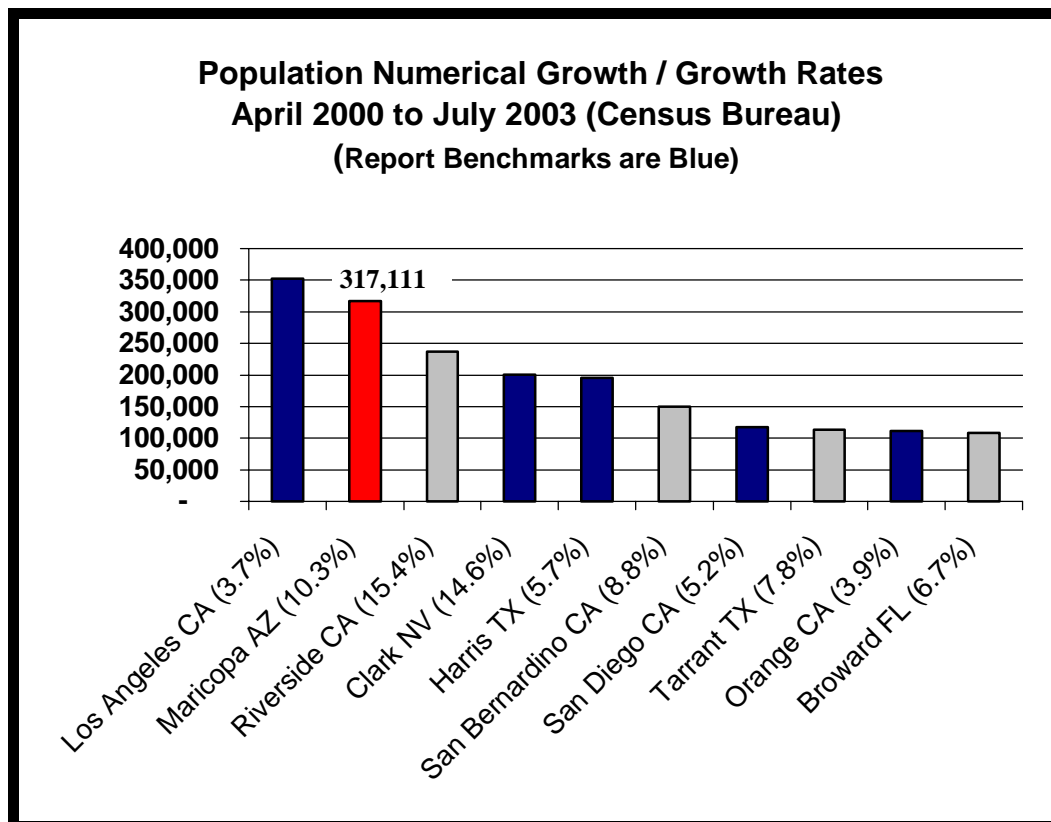
### Fitch — AA+

In November 2003, Fitch upgraded the County's general obligation bond rating from AA to AA+ . The upgrade was based in part on the imminent transfer of the healthcare delivery system to a separate voter-approved health district with its own property tax levy. Fitch also viewed favorably the County's successful fiscal reforms, modest debt profile, and continued economic diversification.

# Population Growth from 2000 to 2003



Since the 2000 census, Maricopa County's population increased over 317,000. Maricopa trailed only Los Angeles County nationally in numeric growth. Only Riverside, CA and Clark, NV exceeded Maricopa County's growth percentage.



# Report Methodology

## **Definition**

Financial Condition is defined as a local government's ability to finance services on a continuing basis. A county in good financial condition can sustain existing services to the public, withstand economic slumps, and meet the demands of changing service needs.

## **Objectives, Scope, and Methodology**

The objective of this report is to evaluate Maricopa County's financial condition using key financial indicators. Indicators were selected from authoritative sources on evaluating governmental entity financial condition and judged to be the most indicative of a county's overall financial health.

This year, our report emphasized Maricopa Integrated Health System, followed by General Fund trends. Our primary information sources were published Comprehensive Annual Financial Reports (CAFR) and MIHS financial statements.

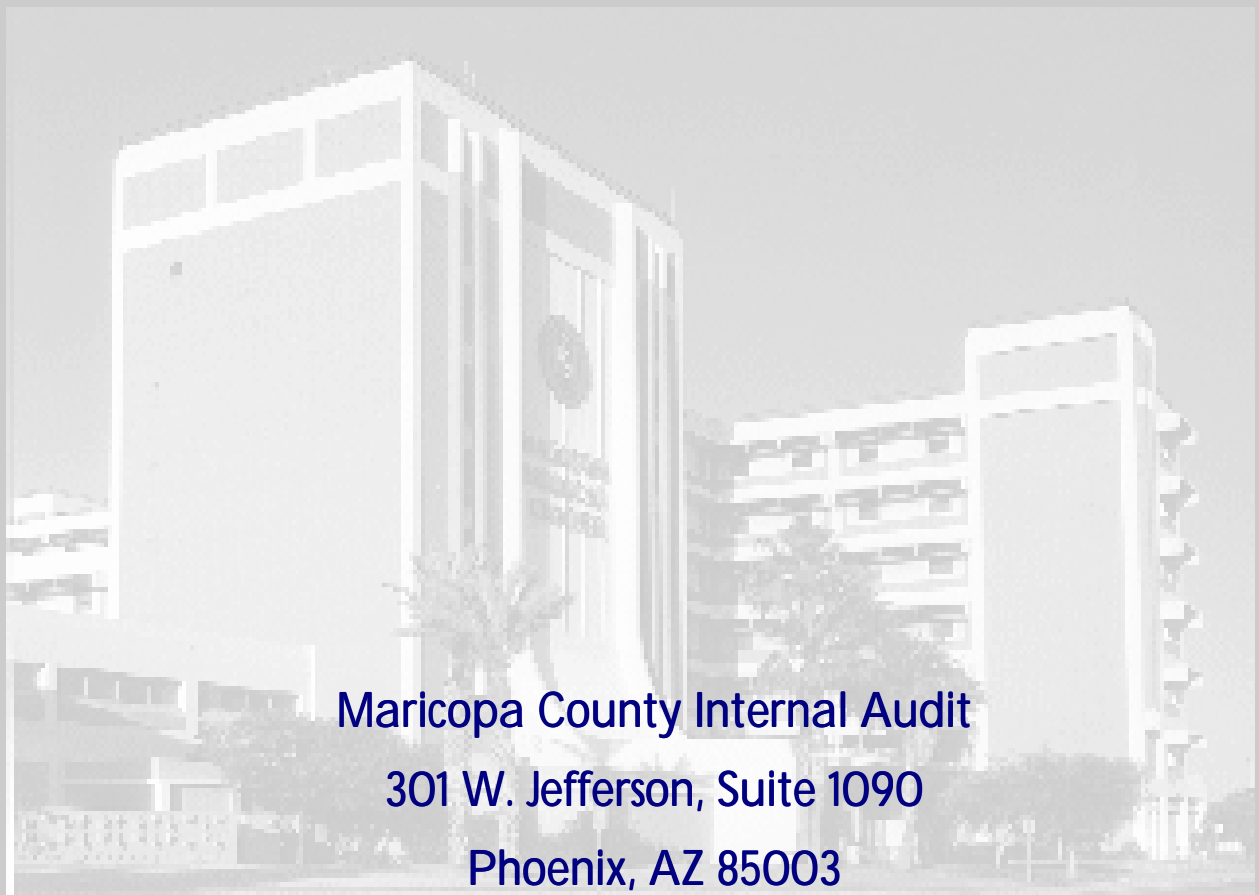
Ten benchmark counties' and Maricopa County's audited financial statements were used as primary sources for comparing General Fund trends. The benchmark counties are:

➤ Clark	(Las Vegas, NV)
➤ Harris	(Houston, TX)
➤ King	(Seattle, WA)
➤ Los Angeles	(Los Angeles, CA)
➤ Multnomah	(Portland, OR)
➤ Orange	(Santa Ana, CA)
➤ Pima	(Tucson, AZ)
➤ Salt Lake	(Salt Lake City, UT)
➤ San Diego	(San Diego, CA)
➤ Santa Clara	(San Jose, CA)

Other sources include the Governmental Accounting Standards Board (GASB), the International City/County Managers Association (ICMA), ASU Center for Business Research, Arizona Department of Economic Security Research Administration, Arizona Department of Revenue Econometrics Unit, Maricopa County's Strategic Plans (budgetary documents), and Auditor General Reports.

Trend analysis is used in this report. Trend analysis involves examining financial indicators' historical data over several years. A trend is defined as the direction the data is moving over a five-to-ten year period.

Fiscal years are identified as "FY03" (fiscal year ending June 30, 2003). Numbers are referred to as "actual," otherwise as "adjusted for inflation", "constant", or "real" (e.g., "2003 dollars"). An "actual" number is the amount originally published in the CAFR. An "adjusted for inflation" or "constant" number has been adjusted to the purchasing power of a 2003 dollar. The adjustment for inflation was made according to the "U.S. Consumer Price Index—All Items."



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